11-1005-8377-2

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA DEPARTMENT OF COMMERCE

In the Matter of TNT Industries,
a Minnesota corporation, and
Bradley Clifford, Its President

FINDINGS OF FACT,
CONCLUSIONS AND
RECOMMENDATION

The above-entitled matter came on for hearing before Administrative Law Judge Barbara L. Neilson on December 9, 1993 at 1:30 p.m. in Courtroom 10, Office of Administrative Hearings, 100 Washington Square, Suite 1700, in Minneapolis, Minnesota. The hearing was concluded that day. The record in this matter closed on February 18, 1994.

Prentiss Cox, Assistant Attorney General, Suite 1200, NCL Tower, 445 Minnesota Street, St. Paul, Minnesota 55101-2130, appeared on behalf of the Minnesota Department of Commerce. Gregory A. Ludvigsen, Attorney at Law, 500 Baker Building, 706 Second Avenue South, Minneapolis, Minnesota 55402-3006, appeared on behalf of the Respondents, TNT Industries and Bradley Clifford.

This Report is a recommendation, not a final decision. The Commissioner of Commerce will make the final decision after a review of the record which may adopt, reject or modify the Findings of Fact, Conclusions, and Recommendations contained herein. Pursuant to Minn. Stat. 14.61, the final decision of the Commissioner shall not be made until this Report has been made available to the parties to the proceeding for at least ten days. An opportunity must be afforded to each party adversely affected by this Report to file exceptions and present argument to the Commissioner. Parties should contact James E. Ulland, Commissioner, Department of Commerce, 133 East Seventh Street, St. Paul, Minnesota 55l0l, to ascertain the procedure for filing exceptions or presenting argument.

STATEMENT OF ISSUES

The issues in this contested case proceeding are whether the

Respondents have violated the provisions of Minn. Stat. Chapter 80C by selling and offering for sale a franchise without registering the franchise with the Commissioner of Commerce as required by Minn. Stat. 80C.02, and whether the Commissioner should make the Cease and Desist Order against Respondents permanent.

Based upon all of the proceedings herein, the Administrative Law Judge makes the following:

FINDINGS OF FACT

1. Bradley Clifford formed Telecommunications Network Technological Industries, referred to as "TNT Industries," in November of 1982. Mr. Clifford is the President of TNT Industries. Prior to 1993, he was also the sole manager or employee of the company. Although Mr. Clifford consults with three informal advisors, he retains sole control of TNT Industries. TNT Industries initially was involved in long distance resale. In 1985, TNT Industries received authority from the State of Minnesota to own and operate pay telephones. Since that time, TNT Industries and Mr. Clifford (hereinafter referred to jointly as "TNT"), have been involved in consulting, performing audits for telephone services, networking in long distance set-ups, and cellular telephone projects. TNT started selling pay telephones to others in 1992. Its only sale has been to Richard Morse.

2. Richard Morse is a resident of New Brighton, Minnesota. He graduated from college in 1973 with a degree in electrical engineering. Following his graduation, he worked in several positions involving engineering and computer software and programming. Since 1987, he has worked as a computer software consultant.

3. In early 1992, Mr. Morse became interested in purchasing a business and began to explore the possibility of buying vending machines and pay telephones. He wanted to own a profit-generating business in a field that might lend itself to the development of computer software. He had never owned or operated any type of business prior to 1992 and did not have any particular knowledge of the pay telephone industry.

4. In approximately March of 1992, TNT placed a classified advertisement in the Business Opportunities or Businesses for Sale section of the classified advertisements contained in the Minneapolis Star & Tribune. The advertisement stated as follows: "PAY PHONES. Lease/purchase, 1/3 dn, positive $ flow, 10 sites. $26,500. 937-5966." (Exhibit A.)

5. Mr. Morse saw the advertisement placed by TNT in approximately March of 1992. Mr. Morse talked to Mr. Clifford on the phone and met with Mr. Clifford two to three times during March. During these meetings, Mr. Clifford told Mr. Morse about the pay phone industry in general and how to go about getting into the field. Mr. Clifford showed Mr. Morse documentation containing information concerning income earned at various pay phone locations. During his meetings with Mr. Clifford, Mr.

Clifford offered to sell Mr. Morse pay phones, as well as take care of all filings with government agencies necessary to operate a pay phone business. Mr. Clifford told Mr. Morse that he would provide reports on actual revenues received by phones operated by U.S. West (referred to as "13-month average daily income reports" or "audits"). He also told Mr. Morse that Mr. Morse could select any of these locations and Mr. Clifford would negotiate agreements with the owner/operator of the pay phones at the selected locations.

6. On March 26, 1992, Mr. Morse entered into an agreement with TNT in which Mr. Morse agreed to purchase five coin-operated telephones from TNT for a total amount of $10,850 plus $360.27 in sales tax. The total purchase price was to be paid in four installments. TNT agreed, inter alia, to provide Mr. Morse with a monthly average income statement based on a 13-month average from U.S. West for each potential pay phone location. TNT agreed to "secure location agreement(s) acceptable with the buyer [Mr. Morse] for the rights to place the telephone(s) in location(s) that meet the reasonable economic goals of buyer and seller." The location agreements were to be "set up with a 1 to 5 year agreement with two 1 to 5 year options to renew provided all terms and conditions are met between the buyer and the locations owner." It was stipulated that this renewal "is the sole responsibility of the buyer." TNT also agreed to coordinate all of the filings with the Public Utilities Commission and the Department of Public Service and to coordinate all of the necessary telephone network responsibilities of the telephones. TNT provided a one-year warranty on parts only with respect to the telephones. In addition, the agreement provided as follows:

> The seller represents that the past 13 month audit that comes from U S West is only an indicator of the possible income in the future and has [sic] no control of business failure, acts of God, fire, theft or damage of the telephone at the location site, or any unnamed aspect to the location or circumstances of the buyers [sic] business operation that may or may not change.
>
> Seller guarantees buyer that the locations will generate the average monthly income documented from U S West and if the location is not performing for reasons other than seasonal fluctuations, or the above aforementioned reasons that are the responsibility of the property and not the seller; seller will provide buyer with a new location with in [sic] a reasonable period of time not to exceed more than 45 days.

(Exhibit B at 1-2.)

7. At the time the March 26, 1992, agreement was executed, Mr. Morse gave TNT a check in the amount of $2,712.50 as a downpayment toward the total purchase price. (Exhibit C.)

8. Mr. Clifford thereafter prepared and Mr. Morse signed a Certificate of Assumed Name to be filed with the Office of the Secretary of State and an Application for Authority to Provide

Coin-Operated Telephone Service in the State of Minnesota to be filed with the Minnesota Public Utilities Commission. (Exhibits D and E.)

9. After the agreement was executed, Mr. Clifford gave Mr. Morse a copy of an "audit report" relating to 13 coin-operated telephones. The audit report showed gross revenues, line charges, charges for long-distance calls, tax, rental amounts paid to the owner of the premises, net revenues, and return on investment for each of the various locations. The information provided in the audit report referring to "R.J. Royce" in fact pertained to "R.J. Riches." (Exhibit F.) Based upon the audit report, Mr. Morse selected five pay telephone locations, one at R.J. Riches and four at Minneapolis City Hall.

10. During the summer of 1992, Mr. Morse met approximately five times with Mr. Clifford. They jointly developed a preliminary agreement form which was to be used by Mr. Clifford in negotiating pay telephone locations on behalf of Mr. Morse. The agreement was to be signed by Morse Telecommunications of New Brighton, Minnesota, as licensee and by the location owner as licenser. The form also called for the signature of Bradley N. Clifford of TNT Industries, Inc., as the "Location Agent." (Exhibit G.)

11. On August 11, 1992, Mssrs. Clifford and Morse entered into an Addendum to the March 26, 1992, Purchase Agreement. The Addendum noted that Mr. Morse had received 13 audit reports, four space contracts, a PUC application for authority to operate coin telephones in Minnesota, and a DBA application from the State of Minnesota. The telephone locations selected by Mr. Morse were identified in Schedule A to the Addendum. Pursuant to the Addendum, Mr. Clifford agreed to prepare the space provider contracts and present them to Mr. Morse for his approval by August 14, 1992, and agreed to complete the location agreements on or before September 15, 1992. The agreement required Mr. Clifford to credit to Mr. Morse $562.00 as a penalty fee if the September 25, 1992, completion date were not met. (Exhibit H.)

12. In accordance with the terms of the Addendum, Mr. Morse provided a check to TNT Industries on August 11, 1992, in the amount of $3,797.50. (Exhibit I.) At this point, Mr. Morse had paid to TNT the total amount of $6,508.00.

13. Pursuant to the agreements between the parties, Mr. Morse would conduct business under the name of Morse Telecommunications. Mr. Morse would not use any trademarks or copyrights from TNT and TNT would not have any on-going interest in Mr. Morse's business. Although Mr. Morse could contract with TNT to provide additional services after the pay telephones were located and installed, he was under no obligation to do so.

14. No completed location agreements were ever given to Mr. Morse by TNT for his signature. In addition, Mr. Morse never received any pay telephones from TNT. Mr. Morse does not now possess or operate pay telephones.

15. In late 1992, Mr. Morse demanded a refund of the money he

had given to TNT. As of the date of the hearing, TNT had refunded to Mr. Morse approximately 10% of the total amount he had paid. TNT has agreed to make monthly payments until the entire amount is repaid.

16. Neither Bradley Clifford nor TNT Industries has registered with the Minnesota Commissioner of Commerce to offer a franchise for sale under Minn. Stat. Chapter 80C (1992). (Joint Exhibit 1.)

17. On or about May 4, 1993, the Commissioner of Commerce issued a Cease and Desist Order to TNT and Mr. Clifford in which he asserted, inter alia, that the "Respondents' offer or sale of the telphones, and related goods and services, including Respondents' representations that Respondents would secure locations for the telephones and guarantee income from the business venture, constitutes a franchise, as defined by Minn. Stat. 80C.01, subd. 4 (1992)." The Commissioner ordered that Respondents "cease and desist from offering or selling the above-described or any other franchises in the State of Minnesota until compliance with Minn. Stat. ch. 80C (1992) has been achieved and until further order of the Commissioner." The Cease and Desist Order notified the Respondents of their right to request a hearing.

18. This contested case proceeding was initiated following a timely request for hearing by the Respondents. The Respondents and the Department agreed to waive the requirement set forth in Minn. Stat. 45.027, subd. 5, that the hearing be held not later than seven days after the request for hearing was received by the Commissioner.

Based upon the foregoing Findings of Fact, the Administrative Law Judge make the following:

CONCLUSIONS

1. The Commissioner of Commerce and the Administrative Law Judge have jurisdiction in this matter pursuant to Minn. Stat. 45.027, subd. 5 and 14.50.

2. The Department of Commerce has given proper notice of the hearing in this matter and has otherwise fulfilled all relevant substantive and procedural requirements of law or rule.

3. Minn. Stat. 80C.02 (1992), provides that "[n]o person may offer or sell any franchise in this state unless there is an effective registration statement on file in accordance with the provisions of sections 80C.01 to 80C.22 or unless the franchise or transaction is exempted under section 80C.03."

4. Minn. Stat. 80C.01, subd. 4 (1992), defines the term "franchise" to include the following:

> (c) the sale or lease of any products, equipment, chattels, supplies, or services to the purchaser, other than the sale of sales demonstration equipment, materials or samples for a total price of $500 or less to any one

person, for the purpose of enabling the purchaser to start a business and in which the seller:

> (1) represents that the seller, lessor, or an affiliate thereof will provide locations or assist the purchaser to finding locations for the use of operation of vending machines, racks, display cases, or similar devices, or currency operated amusement machines or devices, on premises neither owned or leased by the purchaser or seller; or
>
> * * *
>
> (3) guarantees that the purchaser will derive income from the business which exceeds the price paid to the seller; . . . .

5. The Department bears the burden to show by a preponderance of the evidence that the Respondents improperly offered or sold a franchise without filing a registration statement. Minn. Rules pt. 1400.7300, subp. 5 (1991).

6. The Department has shown that the Respondents' pay telephone transaction with Richard Morse constituted the offer or sale of a "franchise" within the meaning of Minn. Stat. 80C.01, subd. 4(c)(1) (1992), and that the Respondents have not filed a registration statement with the Commissioner of Commerce.

7. The Department has not shown that the Respondents violated the Commissioner's Cease and Desist Order issued on May 4, 1993.

8. Pursuant to Minn. Stat. 45.027, subd. 6 (1992), the Commissioner of Commerce may impose a civil penalty not to exceed $2,000 per violation upon a person who violates Chapter 332 or any order issued under that Chapter.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

RECOMMENDATION

IT IS RESPECTFULLY RECOMMENDED that the Commissioner of Commerce make the Cease and Desist Order in this matter permanent and impose an appropriate civil penalty upon the Respondents.

Dated this 18th day of March, 1994.

s/ Barbara L. Neilson

BARBARA L. NEILSON
Administrative Law Judge

NOTICE

Pursuant to Minn. Stat. 14.62, subd. 1, the agency is required to serve its final decision upon each party and the

Administrative Law Judge by first class mail.

Reported: Tape-recorded.

MEMORANDUM

In order to prevail in this proceeding, the Department must show that the Respondents offered or sold a franchise in Minnesota without filing a registration statement with the Commissioner of Commerce. While the Respondents concede that they were not registered with the Commissioner, they argue that the transaction at issue in this case does not fall within the definition of "franchise" contained in the statute.

The Department first asserts that the pay telephone transaction between TNT and Mr. Morse falls within the statutory definition of a "franchise" as "the sale . . . of any products, equipment, chattels, supplies, or services to the purchaser . . . for the purpose of enabling the purchaser to start a business and in which the seller: (1) represents that the seller . . . will provide locations or assist the purchaser in finding locations for the use or operation of vending machines, racks, display cases, or similar devices . . . on premises neither owned or leased by the purchaser or seller . . . ." Minn. Stat. 80C.01, subd. 4(c)(1) (1992). The phrase "vending machines . . . or similar devices" is not defined in the statute or in the rules promulgated by the Department of Commerce. TNT contends that coin-operated telephones are not "vending machines or similar devices," based upon definitions of "vending machines" found in rules promulgated by other agencies. TNT also asserts that the definition does not cover the transaction involved in the present case because, pursuant to the agreement between the parties, TNT was to help Mr. Morse find locations on premises which would be leased by Mr. Morse.

Similar issues were raised in Hornsby v. Phillips, 378 S.E.2d 870 (Ga. Ct. App. 1989). The plaintiff in that case had entered into a contract with Applied Control Systems ("ApCon") for the purchase of 25 coin-operated telephones. After the plaintiff complained about the fact that he had thought he was buying "routes" (i.e., pay telephones together with locations for their installation), the plaintiff and ApCon entered into an assignment agreement under which ApCon assigned ten locations to the plaintiff which previously had been obtained for ApCon. The plaintiff then installed his telephones at those locations. After experiencing mechanical and services difficulties with the phones, the plaintiff sought to rescind the transaction and eventually filed an action against ApCon and its primary officers and shareholders in which he alleged that they had violated the Georgia Sale of Business Opportunities Act. The Georgia Act contains language similar to the Minnesota Act which prohibits "the sale or lease of, or offer to sell or lease, any products, equipment, supplies, or services for the purpose of enabling the purchaser to start a business and in which the seller . . . represents: (i) That the seller . . . will provide locations or assist the purchaser in finding locations for the use or operation of vending machines, racks, display cases or other similar devices, or currency operated amusement machines or devices." OCGA 10-1-410(2)(A)(i).

The defendants appealed the trial court's entry of a verdict for the plaintiff. On appeal, the Georgia Court of Appeals held that the sale of coin-operated telephones and the assignment of locations for the telephones was covered by Georgia's Sale of Business Opportunities Act. The court stated:

> Contrary to appellant's argument, is is clear that the definitions in the Act cover the conduct complained of here. Although the statute does not state specifically that it is applicable to coin operated telephones, neither does it state that it is not. In this case, when the statute was enacted, private ownership of coin operated telephones was not permitted. However, the evils contemplated and sought to be remedied by the Act would be equally possible as to privately owned coin telephones, once that became a possibility, as to any other vending machine. Further, we know of no reason a coin operated telephone may not be considered a vending machine. It simply dispenses a service instead of a product upon insertion of a coin. There are other such "service-vending" machines; for example, machines which weigh the vendee, or ascertain his or her blood pressure.

378 S.E.2d at 873. 1/ The court pointed out that the plaintiff had alleged in
his action that ApCon had misrepresented material facts in advertising and

1/ In reaching its conclusion that the offer and sale of pay telephones fell within the coverage of the Georgia Business Opportunities Act, the court emphasized that the company's sales literature referred to the privately-owned pay telephone as "The Ultimate Vending Machine" and asserted that pay telephones were "the highest earning vending machines." The court also pointed out that the company's attorney had advised the company that its offer to sell phones and provide locations violated the Georgia Act. Id.selling the coin-operated telephones and stressed that the purpose of the Georgia Act was to "prevent and prohibit fraudulent and deceptive practices in the sale of business opportunities." The court concluded that "the gist of the action brought by appellee was the very essence of the legislative intent in enacting the statute." Id. at 874.

The rationale of Hornsby applies equally to the present case. While pay telephones were not privately owned at the time Chapter 80C was enacted in 1973, there is no suggestion in the statute that coin-operated telephones were meant to be excluded from coverage as "vending machines or similar devices." Moreover, when the problems sought to be remedied by passage of the Minnesota law are examined, there is no reason to distinguish between transactions involving vending machines that dispense services, such as pay telephones, and those involving vending machines that dispense goods. In Martin Investors, Inc. v. Vander Bie, 269 N.W.2d 868, 872-73 (Minn. 1978), the Minnesota Supreme Court summarized the purposes of Chapter 80C of the Minnesota Statutes as follows:

> Chapter 80C was adopted in 1973 as remedial legislation designed to protect potential franchisees within Minnesota from unfair contracts and other prevalent and previously unregulated abuses in a growing national franchise industry. See, Note, 59 Minn. L.Rev. 1027, 1036. Like most other states' franchise regulation acts, all of relatively recent passage, c. 80C seeks to achieve this protection principally through requiring that any person offering or selling a franchise within the state shall register with the commissioner of securities a proposed public offering statement, making full disclosure of all facts required by state or rules of the commissioner. See, 80C.04 and 80C.06. The franchiser is required to present the public offering statement to each prospective franchisee at least 7 days before any franchise contract is entered or any consideration is paid by the franchisee. 80C.06, subd. 5. The person offering or selling a franchise must file an annual report with his registration, 80C.08, and also keep a set of books and records open to inspection by the commissioner. 80C.10. The commissioner is given power to deny, suspend, or revoke registration upon any of the grounds stated in 80C.12 or to impose such conditions, limitations, or restrictions as he deems necessary to carry out the purposes of the act. 80C.15. Failure to register a franchise contract "offered or sold" within Minnesota violates 80C.02 and subjects the franchiser to liability for damages, rescission, or such other relief as the franchisee may seek under 80C.17.

Accord Chase Manhattan Bank v. Clusiau Sales & Rental, Inc., 308 N.W.2d 490, 494 (Minn. 1981). It is evident that the registration and disclosure requirements set forth in Chapter 80C were designed to assist less sophisticated and experienced buyers, such as Mr. Morse, and that problems with unfair contracts, uneven bargaining power, and inadequate disclosure by the seller are just as likely to occur in pay telephone transactions as in transactions involving other types of vending machines.

The regulations cited by the Respondents in support of a more restrictive reading of "vending machine" are not persuasive. Those regulations pertain only to the types of machines regulated by the Department of Health and the Department of Agriculture, and thus logically are restricted to machines dispensing food, beverages, or other tangible items. As the Department points out, usage of the term "vending machine" is not limited in Minnesota law to machines that dispense goods such as food and beverages. See, e.g., Minn. Stat. 60A.18, 72A.53, and 297.01, subd. 14 (1992). In addition, because the definition of "vending machine" contained in Minn. Stat. 80C.01, subd. 4(c)(1), does not specify that it encompasses only machines that dispense food, merchandise, or particular tangible products as in Minn. Stat. 28A.09, 297.08, 32A.03, and 325D.01, subd. 10 (1992), a broader reading of 80C.01, subd. 4 is warranted.

TNT also argues that the definition of "franchise" set forth in Minn. Stat. 80C.01, subd. 4(c)(1) is inapplicable because TNT did not in fact promise to assist Mr. Morse in finding locations on premises neither owned or leased by TNT or Mr. Morse. In this regard, TNT argues that it was required under its agreement with Mr. Morse to obtain location agreements with individual businesses or property owners on behalf of Mr. Morse and that, accordingly, the telephones would in fact be located on premises leased by Mr. Morse. The Administrative Law Judge must reject this argument. At the time the sale occurred (i.e., March 26, 1992, when the original agreement was executed), the Respondents clearly represented that they would assist Mr. Morse in finding locations for the pay telephones "on premises neither owned or leased by the purchaser [Mr. Morse] or the seller [TNT]," within the plain meaning of the statute. The agreement specified that TNT would "secure location agreement(s) acceptable with the buyer for the rights to place the telephone(s) in location(s) that meet the reasonable economic goals of buyer and seller." Ex. B. Neither TNT nor Mr. Morse actually had leased the space where the pay telephones were to be located at the time that TNT offered or sold the business opportunity to Mr. Morse. The parties did not even begin drafting a sample location agreement until the summer of 1992, several months after the sale. The language of subd. 4(c)(1) clearly looks to the status of the premises at the time the vending machine or similar device is sold to the purchaser; it does not take into account the future arrangement to be made.

Moreover, even if the statute could be interpreted to exempt from coverage situations in which the purchaser later leased premises where a vending machine or similar device was to be located, the location agreement drafted by TNT and Mr. Morse cannot fairly be construed as a "lease" of "premises" within the meaning of the statute. The location agreement drafted by the parties did not specify that Mr. Morse would pay "rent" to a "lessor"; rather, it called for Mr. Morse, as "licensee," to pay a monthly "commission" to the "licenser." Ex. G. The location agreement did not identify a particular space that would be "leased"; instead, it merely provided that the licensor would provide "adequate space" for a pay telephone. A license in real property does not provide the licensee with an interest that is identical to that obtained under a lease. A lease is a conveyance of an interest in real property, while a license merely entitles the licensee to the use of land in the possession of another. See, e.g., Gruman v. Investors Diversified Services, Inc., 247 Minn. 502, 78 N.W.2d 377, 380 (1956); Chica go & North Western Transportation Co. v. City of Winthrop, 257 N.W.2d 302, 304 (Minn. 1977). Based upon the language of the entire location agreement, the Judge is persuaded that it was merely intended to grant a license to Mr. Morse to place a pay telephone on the property and was not a lease of real property. 2/ Under these circumstances, it is appropriate to find that the transaction at issue is covered under the definition of franchise set forth in Minn. Stat. 80C.01, subd. 4(c)(1) (1992), and that the

Respondents improperly offered or sold the franchise without filing a registration statement. Therefore, it is recommended that the Commissioner make the Cease and Desist Order permanent and subject the Respondents to appropriate civil penalties. 3/

B.L.N.

2/ The Respondents emphasize that the location agreement provides that the "Licensee agrees to . . . supply the leased premises with a coin operated telephone system . . . ." Ex. G at 1 (emphasis added). In light of the other provisions of the agreement referring to a licensee-licensor relationship between the parties, however, it is unclear what meaning should be ascribed to this phrase. It is possible that this language was meant to refer to the overall premises leased by the licensor.

3/ Because it has been found that the Respondents offered and sold a franchise within the meaning of Minn. Stat.   80C.01, subd. 4(c)(1), it is unnecessary to consider the Department's further argument that the pay telephone transaction also was the offer or sale of a franchise within the meaning of Minn. Stat. 80C.01, subd. 4(c)(3) (1992).